ORIGINAL

31 Stearns Street
Newton, MA 02459
617 243 0093
fax 617 243 3903
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SENT VIA FEDERAL EXPRESS

davidgabel@aol.com

EX PARTE

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Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
The Portals
445 12th Street, SW
Washington, DC 20554

RE: Ex Parte Presentation to FCC Staff regarding CALLS proposal Notice of Proposed Rulemaking, Docket No. CC Docket No. 96-262, 94-1, 99-249, 96-45

Dear Ms. Salas:

On January 14, 1999 I met with Donald Stockdale, Jay Atkinson, and Aaron Goldschmidt of the FCC Staff to discuss elements of the CALLS proposal for universal service and access reform. These elements included the appropriate levels of subscriber line and access charges and the deaveraging of the subscriber line charges.

During the meeting I handed out the attached presentation to the FCC Staff.

As required by Section 1.1206(b) of the Commission's rules, I am filing two copies of this notice and ask that you place this notification in the record of the proceeding identified above.

Sincerely,

David Gabel

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OFFICE OF THE SECRETARY

David Gabel

Ex Parte Presentation to FCC regarding CALLS Proposal
Notice of Proposed Rulemaking
Docket No. CC Docket No. 96-262, 94-1, 99-249, 96-45
January 14, 2000

Objective of Regulation

- Emulate Outcome of Competitive Markets
- Social Engineering
- Constrain Market Power
- Foster Collusion

Network Industries

- Large Fixed Costs
- Fixed Costs are not Line Specific Costs
- Pricing of information goods is addressed in Shapiro & Varian's Information Rules at p.4:

  "Economists say that production of an information good involves high fixed costs but low marginal costs. The cost of producing the first copy of an information good may be substantial, but the cost of producing additional copies is negligible. This sort of cost structure has many important implications. For example, cost based pricing just doesn't work: a 10 or 20 percent markup on unit cost makes no sense when unit cost is zero. You must price your information goods according to consumer value, not according to your production cost."
- Many of the costs classified as "fixed" are really traffic sensitive. For example, separations currently inappropriately classifies certain line and switch investments as non-traffic sensitive when in fact they are traffic sensitive. The recent congestion experienced on switching machines illustrates that digital switches, including "line units," are engineered based on busy-hour usage. The CALLS proposal, by moving switching costs to a fixed line charge, effectively exacerbates this problem.

Network Industries Continued

- Wireless Services—roaming fees.
- Cable telephony. Platform costs are not recovered via a fixed customer fee.
- Pricing parity. Why should the FCC impose a pricing structure on one form of telecommunications, but not cable telephony or wireless services?
- CLECs generally charge access fees that are comparable to the charges of the ILECs. *Comments of The Association for Local Telecommunications Services,* Before the Federal Communications Commission, In the Matter of Access Charge Reform, CC Docket No. 96-262; Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, October 29, 1999, p.4

US WEST v. AT&T access charges in Colorado

CCLC Rate	U S WEST Rate Per Access Minute	AT&T Rate Per Access Minute
Originating	$0.012395	
Terminating	$0.028608	
Local End Office Switching		
Originating	$0.015120	$0.044692
Terminating	$0.015120	$0.064583
EO Shared Port	$0.001300	
Total of CCLC and EO Switching		
Originating	$0.028815	$0.044692
Terminating	$0.045028	$0.06458

AT&T Communications of the Mountain States, Inc., *Access Services and Network Interconnection Tariff*, Section 17, p.24, Colorado P.U.C. No.2, Issued November 24, 1999.
U S WEST Communications, *Access Services Tariff*, Section 6, Second Revised Sheet 146, Colorado P.U.C. No. 16.

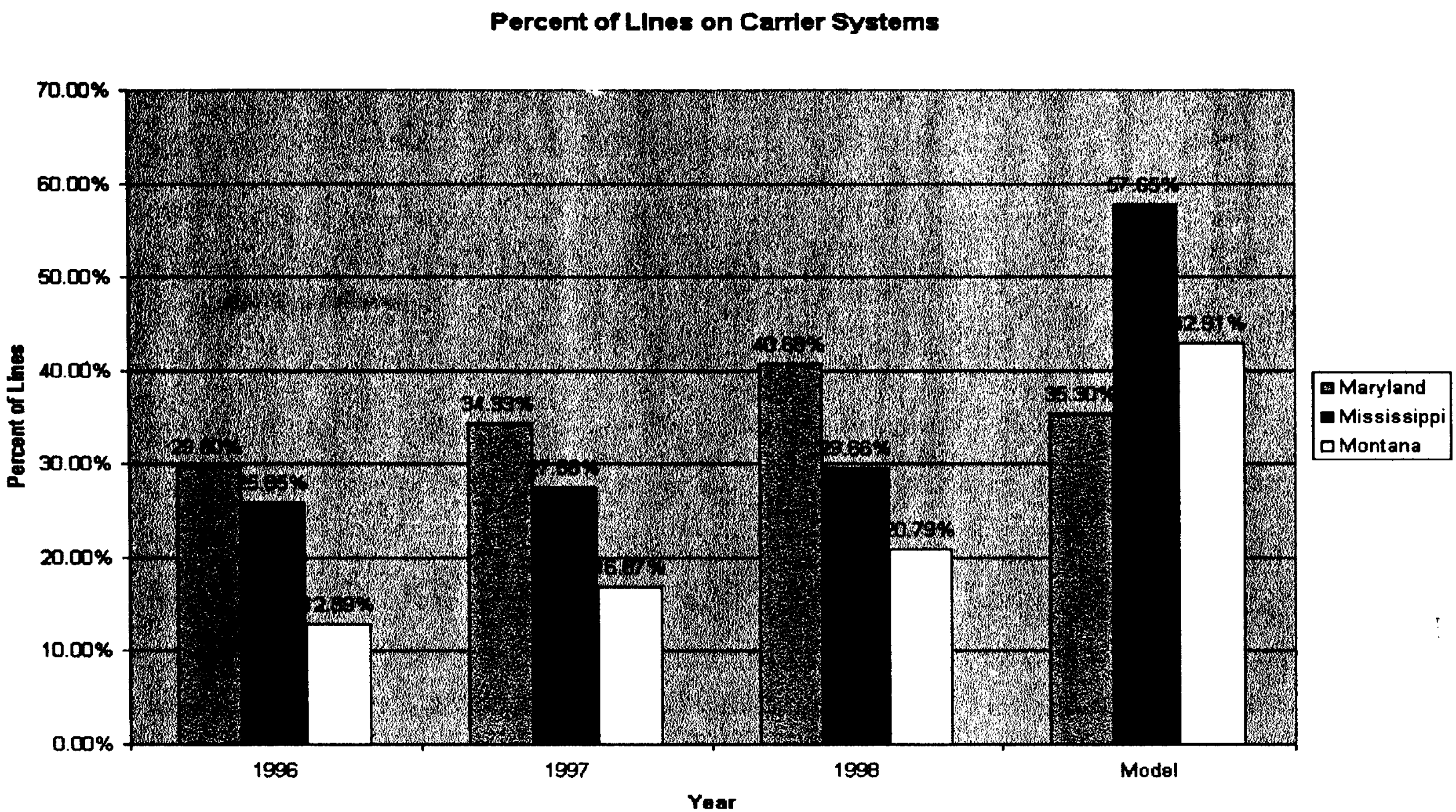
Vertical Services

- CLECs pricing services based on price, not cost. For example, AT&T Colorado offers call waiting at $4.50 per month while the cost of providing the product is *de minimus*.
- Should one set of inputs be priced at cost when retail products are based on value? Which Cost?

How do competitors recover the cost of their platform?

- RCN Network
- Fiber to the optical network unit—analogue of the feeder/distribution interface
- Coaxial to the home that is used for cable TV/telephone/cable modem
- No effort is made to recover this platform through a fixed customer charge that is independent of the services selected. Rather the platform cost is recovered through mixed bundling. Customers are offered the opportunity to buy one service (e.g., a cable modem or cable television service), or various bundles (e.g. cable modem, cable television, and telephone service).
- The evolving telecommunications network is increasingly relying on fiber in the loop. Why should the FCC's prescriptively mandate the recovery of platform costs in a manner that is different than the pricing strategy selected by unregulated telecommunications providers?

Digital Line Carrier



Pricing in Network Industries

- Conclusion: In an age of conversion, the CALLS proposal results in a pricing structure that is not followed by other, unregulated telecommunications suppliers. The CALLS proponents are attempting to use regulation to impose a pricing structure that would not appear in a competitive market.

Theory, Reality and Customer Access Line Charges

- "There is widespread consensus among economists that when costs are fixed, as loop costs are, markets tend to push prices toward flat-rated, rather than usage-based, price structures." CALLS Proposal, Appendix of NPR, at Footnote 59.
- "Competitive private enterprise demands that overhead (i.e. fixed) costs shall be recouped not through fixed charges, as in the theory of the two part tariff suggests but by inclusion in the variable charge ... such devices (two part tariffs) run counter to the spirit of private enterprise. the essence of the system is that entrepreneurs are the special~~s~~ists in risk taking. It is therefore very difficult to introduce such devices into an industry where entry is unrestricted and easy. there is usually some entrepreneur who is willing to charge the consumer per unit consumed, and assumed to himself the risk that over a number of years demand will be large enough for him to recoup all his costs." W. Arthur Lewis, Overhead costs:some essays in economic analysis,Kelly 1970, p56-57.
- Suzanne Scotchmer, "Two-Tier Pricing of Shared Facilities in a Free-Entry Equilibrium," Rand Journal of Economics 16 (1985): 456-472.
- Example: Credit Cards.
- Digital line carriers can be engineered based on busy-hour traffic load. Prospectively about 40% of the lines are served via carrier. The value is increasing over time.

Welfare Gains

- One problem with the standard approach to welfare analysis is that it assumes that a millionaire and a homeless person obtain the same marginal utility from an additional dollar of income. In the telecoms context it assumes that the social welfare benefits to be gained by reducing the price of toll service will offset any loss in social welfare caused by customers dropping off the network as a result of increased prices for basic services.
- Wenders points out that relying on individual decisions, rather than some arbitrary welfare function, is the essence of competitive markets: "But the desirability of the competitive approach is not that it maximizes the sum of the surplus, but that it maximizes individual voluntary exchanges, each of which leave both parties better off." Wenders, John T., "Two Views of Applied Welfare Analysis: The Case of Local Telephone Service Pricing", Southern Journal of Economics 57 (1989), p. 340.
- Elasticity Estimates. Separating structural changes in the economy (e.g., the impact of faxes), from the a response to a price change.
- Experience of Maine.
- What will be the level of the SLC if State's establish access rates that are at parity with the Federal rates?
- Access will reach $0.005 under price caps without increased SLC.

Subscriber Line Charge and Deaveraging